SECRET [redacted] 25X1

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Mexico: Post-Election Economic Problems

With the election "successfully" behind, Mexican President de la Madrid will now be forced to take action on the economy. [redacted] 25X1

To date, Mexico has taken only limited action to reverse these trends.

-- Only a week before the election the government began to allow some dealings in the peso at free market rates while reserving the controlled rate for most transactions in order to prevent an increase in inflation.

-- Oil prices were also cut recently, although not nearly enough to bring exports back to maximum sustainable rates.

We can only speculate at this point on future economic moves, but clearly some new measures will be needed in the face of continuing financial problems.

-- de la Madrid may soon devalue the peso, [redacted] 25X1

-- There will also likely be another oil price reduction, although likely still not one sufficient to cause a sharp rebound in oil exports.

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Any major moves to bring domestic spending down to reduce significantly the fiscal deficit hinge in part on an internal policy debate between Finance Minister Silva Herzog--a proponent of more conservative fiscal policies--and Budget Minister Salinas who favors continued high levels of government spending. [redacted] 25X1

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Should de la Madrid decide on a series of partial economic measures including some token budget reductions and a partial devaluation, Mexico may well be back to the commercial banks and the U.S. government for more money either later this year or in early 1986. For their part, the banks would want Mexico to sign a new agreement with the IMF--something Mexico City could not do without a promise and, indeed, action to cut government spending substantially.

-- Mexico's efforts to prop up oil prices and the resulting loss in revenues have already alienated the de la Madrid administration from Western bankers and some governments, making it difficult for the Mexicans to make a case for additional funds.

-- A decision to replace Herzog with a new minister less inclined to austerity would further compound de la Madrid's problems in coming to terms once again with Mexico's creditors.

To the extent that further missteps cause Mexico's economic performance to worsen, Mexico City will begin to look for scapegoats, including, no doubt, the burden of foreign interest payments. Similar pressures may also be building in Brazil where President Sarney has yet to chart an economic course that will prevent that country from experiencing future payments problems. For his part, Peru's President-elect Garcia has been quite vocal about the need for a new plan to deal with Latin debt.

-- While none of these elements adds up as yet to the likelihood of concerted action on debt by these and other Latin countries, increasing financial difficulties coupled with weak economic leadership increases the prospects for such a move.